Why Taxing Companies to Discourage Outsourcing Won't Work

Gary Clyde Hufbauer says President Obama's proposal to tax firms that outsource jobs will backfire and compel companies to sell off their foreign operations.

Transcript of interview recorded January 25, 2012.

Steve Weisman: President Obama's State of the Union message in January came with tax proposals that look like a new 2012 model of some of the ones we've seen before. They're designed to encourage "in-sourcing," and discourage outsourcing of jobs. Gary Hufbauer, senior fellow at the Peterson Institute, is here with me, Steve Weisman, to tell me what's new, interesting, surprising, good or bad about these proposals. Let's start with, was there anything new?

Gary Hufbauer: Not really new, but the tax proposals have three main elements. One, very familiar, the Buffet rule: tax millionaires and billionaires at least 30 percent.

Steve Weisman: Right.

Gary Hufbauer: That's been pretty well advertised. The new part about that, which is more recent, is that the higher rate only applies if you have a million dollars of income or more. Previously, it was at $250,000.

The other part, which is an old theme going back to the 2008 campaign, and we've written about it extensively on the Peterson website, is the notion that US firms operating abroad are enjoying some kind of give-away by not being taxed by the United States. This is a complete misunderstanding. It's very unfortunate he repeated that again last night, and I'll go into that a little more later.

The third part, which is again not entirely new, but fairly recent, is that he is actually talking about reducing the tax rate on firms doing business in the United States, and he acknowledged—and I really applaud the president for this—he acknowledged that we have almost the highest tax rate in the world on firms doing business here. Thirty-five percent on the federal level and an average of 4 percent at state level, so we're about 39 percent, which is just a shade under Japan. Everyone else is down in the 20 to 25 percent range.

Steve Weisman: Let's talk about the second one, which you said reflected a misunderstanding by the White House. What don't they understand? Why is this a flawed proposal?

Gary Hufbauer: They've had a theme—which goes back to 2010 and President Obama emphasized it again—of doubling exports. About three quarters of our exports are accounted for by a fairly small handful of large firms, let's say a thousand large firms, and these are all taxed at high rates here in the United States.

The very strong evidence is that when these firms go abroad and invest abroad, they attract exports from the United States. That's a big part of our export push. So, if you're going to try to get these firms all to come home, you're going to lose market presence in

India, China, you name it. We're going to lose it. The second thing is that there's no major country in the world that now does what President Obama is suggesting -- namely, apply its home tax rates to the foreign operations of its multinational corporations. So this requires a little bit of thought, but I'm sure it's understood, they just don't properly understand it in the White House.

If we put on our high tax rates on US firms doing business abroad, they're going to be bought up over time. They're going to be bought up by British firms, by Japanese firms, by Dutch firms, by Indian firms, Brazilian firms, you name it, because none of them will pay the same tax rate that US firms have to pay for operating abroad.

Steve Weisman: Couldn't they circumvent that issue? Is it even legal for the United States to tax a semi-autonomous entity abroad?

Gary Hufbauer: Under our law, if a firm is controlled by a US parent firm, if the foreign firm is controlled by a US parent firm, it is subject to US taxes.

Steve Weisman: Controlled, meaning more than ...

Gary Hufbauer: More than 50 percent is the normal definition; sometimes it can be a little less than that. So, no, I don't think it's easy to circumvent it, but what we would do is, gradually, over time, sell off our crown jewels. It's just a hopelessly bad idea, and fortunately, no one in the Senate Finance Committee or the House Ways and Means Committee really wants to pursue it.

Steve Weisman: We can't discuss motives with a perfect knowledge, but they've run into a brick wall on this proposal for years. But it does get applause.

Gary Hufbauer: Yes, I think it gets applause because of the very simple and misleading idea that if a firm, like let's say Intel, opens up a factory, for example, in Korea, it's choosing between Korea and the United States. And I understand that simple logic, I think everyone understands it, and that's the applause line. That happens not to be the economic connection, but as a sound bite, it's probably not a bad one.

Steve Weisman: Let's go to the other one I want to talk to you about, which is the lowering of taxes to encourage job creation and investment in the United States. You said you applauded that, but doesn't that smack of industrial policy?

Gary Hufbauer: No, I don't think so. We have a tax system in this country which has, at the business side, two parts. Half of business activity in the United States is not taxed at the business level – that is, with the corporate tax – because these are partnerships, they are master limited partnerships. We have a whole zoo of these firms that are not taxed at the corporate level.

The big, competitive firms which are household names to everybody -- IBM, GM, Siemens, you name it -- they are taxed at the corporate rate. They can't really organize in these other forms, and they pay the 35 percent statutory rate, which as I say is higher than any other country except Japan.

So to lower that across the board would be pretty sensible policy for encouraging these firms to expand here. And when taxes matter, when taxes are making the difference to think

	of the US as a better place to do business. Incidentally, our research shows that reduction to the order of 25 percent would not lose any revenue. I know that's hard for people to understand, but you get an expansion of output which offsets the revenue loss on the rate.
Steve Weisman:	Also, the corporate taxes have so many incentives and provisions —some would call them "loop-holes"—that their effective rate is not as high as the maximum rate you mentioned anyway.
Gary Hufbauer:	You're right. Our effective rate is about 27 percent, and that's lower than 35 percent, but the effective rate in our competitor countries—and I'm excluding China from this comparison— is about 20 percent, so we're somewhat higher than they are.
Steve Weisman:	President Obama vowed to double exports, and he said that the US was on the way to doing that ahead of schedule. Does Obama get any credit for that?
Gary Hufbauer:	I have to beg to differ. I don't think we are on schedule to do it. We got a big jump from 2009 to 2010 and then the export growth has slowed off somewhat in 2011. President Obama gets credit for the London Summit and other summits which encouraged all countries to come in with super easy monetary policies and fiscal policies which really, in my view, rescued the world from a second Great Depression. Of course, a second Great Depression would be very bad for exports. So we're not growing great, but we're not in a depression, and he deserves a lot of praise for that, and that was the big jump from 2009 to 2010.
Steve Weisman:	But other factors have been that the US economy is in such bad shape that we aren't importing as much, and the value of the dollar.
Gary Hufbauer:	There are a couple other factors which count. Certainly the fact that the US economy is so weak means that firms better look for export markets if they want to continue selling, and some of the big firms are doing that. Second, the dollar was, until the European crisis, somewhat weaker against all other currencies. That was encouraging. And third, as the President mentioned, he has opened these trade agreements, but they take time to pay off in terms of additional exports. So there have been other things that have added in to the tendency. But with the outlook, not only in the US, but the world economy rather slow growth – the IMF just cut its forecast – it's really hard to see the doubling by 2014.
Steve Weisman:	Thank you, Gary.
Gary Hufbauer:	Thank you.